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IN THE

Supreme Court of the United States

October Term, 1966.
No. 949

ESTATE OF MAX STEINBERG, Deceased, PEARL STEINBERG, Executrix and PEARL STEINBERG, Individually,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

Petitioners hereby petition this Court for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

Opinions Below.

The memorandum findings of fact and opinion of the Tax Court are not officially reported. Unofficially, they are reported at 24 TCM 1250. The opinion of the Court of Appeals [App. pp. 1-4] is reported at 367 F. 2d 130.

Jurisdiction.

The judgment of the Court of Appeals was rendered October 10, 1966. [App. p. 1]. The jurisdiction of this Court is based on 28 U.S.C. §1254(1).

Questions Presented.

This is a federal income tax case. The taxpayers were husband and wife. For the two years involved, 1950 and 1951, they filed joint returns. As stated by the Court of Appeals, the assessment for each of those years was barred unless the return was fraudulent, and the burden of showing fraud was on the Commissioner. There are essentially two questions, as follows:

1. Whether an allegation by the Commissioner, in his answer, of undisclosed income of the husband alone, followed by a denial by him, in his brief after the trial; of undisclosed income of the wife, can sustain a determination by the Tax Court that there was undisclosed income of the wife, with the failure to disclose it due to fraud.
2. Whether the Commissioner can sustain his burden of proving fraudulent omission of income by showing net worth increases, without credit for an opening cash hoard alleged by the taxpayers, where the taxpayers fail to prove, to the trial court's satisfaction, the existence or source of the cash hoard, but it is established for the taxable years involved that there was no possible taxable source for the net worth increases alleged.

Mindful of the limitations of certiorari, we pass the further question whether the Tax Court properly struck Pearl Steinberg's testimony, also the question whether the Tax Court's alternative derogation of her testimony was independent of its order striking it, and also the question whether the Tax Court misinterpreted the testimony of the Commissioner's witnesses in respect of leads given them. For the purpose of this petition we limit ourselves to the two questions above because of their great importance in the administration of the revenue.

Tax Court Rule Involved.

Rule 14. Answer.

(b) Form of answer.—The answer shall be drawn so that it will advise the petitioner and the Court fully of the nature of the defense. It shall contain a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commissioner relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed upon him. . . .

Statement.

The petitions in the Tax Court were filed by Max and Pearl Steinberg, husband and wife. Max died shortly after the trial. Thereafter Pearl alone prosecuted the case in her own right and as executrix of Max's estate. [App. p. 2].

Max and Pearl were married in 1942. The Commissioner determined deficiencies against Max for the years 1947, 1948, and 1949, for which Max and Pearl filed separate returns, and against both for 1950 and 1951, for which they filed joint returns. The assessment for each year was barred unless the return for that year was fraudulent. The burden of showing fraud was on the Commissioner. [App. p. 2].

The Commissioner for that purpose used the "increase in net worth" method. [App. p. 2]. In his answer filed in the Tax Court for 1950 and 1951 he stated that the income alleged by him for each of those two years was derived from "petitioner Max Steinberg's business, investments, and/or other sources." [App.

p. 4]. As to Pearl he stated in his brief in the Tax Court after trial and covering all five years: "there is not even a hint of a source of taxable income to Pearl Steinberg during the taxable years involved, other than the income reported by her." [App. p. 5]. The Tax Court completely absolved Max, thus determining no deficiencies for the first three years, for which only Max's separate returns were challenged by the Commissioner. [App. p. 2]. Thus also the Tax Court by implication rested its determination for the last two years, for which it did determine deficiencies, on the assumption, contrary to the above-quoted allegation in the Commissioner's answer, and contrary to the above-quoted statement in the Commissioner's brief, that there was undisclosed income of Pearl.

Prior to the Tax Court's findings and opinion the record is wholly wanting in any assertion, or any implication, by allegation of the Commissioner or in any other way, that there was undisclosed income of Pearl. For that reason the petitioners complained in the Court of Appeals that the Commissioner's answer in the Tax Court did not advise them fully of the nature of his defense as required by Rule 14(b) of that court, more specifically that they did not know that the Commissioner was asserting undisclosed income of Pearl. [App. pp. 3-4]. Nevertheless, the Court of Appeals in its opinion states:

> "The Commissioner's answer before the Tax Court leaves no doubt that he did not know where the unreported income came from, and that he had no intention of limiting his basis for deficiencies to unreported income generated by Max alone."

The Commissioner may contend that this was warranted by the words "and/or other sources" in the Commissioner's answer, as quoted above. We shall not offend this Court by quoting from texts of high-school English to show that those words, because of the parallel structure of the sentence, necessarily refer back to, and are limited by, the words "petitioner Max Steinberg's" which mediately precede them. Also, if the Commissioner had no intention of basing the deficiencies on unreported income generated by Max alone, there was no reason for the words, "petitioner Max Steinberg's," there at all. Nor would he have limited himself to Max's returns for 1947, 1948 and 1949, the years for which separate returns were filed.

The above-quoted statement of the Court of Appeals just makes no sense. This is all the more so because that court could simply have quoted the Commissioner's answer, thus extravagantly interpreted by it, in less than half the words.

It is obvious that the Court of Appeals did so interpret it in order to cover the clear and direct conflict with the Ninth Circuit set forth below under "Reasons for Granting the Writ." It was also clear error, we believe, to sustain a determination of undisclosed income on the basis of income of the wife where the Commissioner has conceded that there was "not even a hint of a source of taxable income" to her.

Reasons for Granting the Writ.

1. The principal reason for granting the writ consists of a direct conflict with the Court of Appeals for the Ninth Circuit on the necessity of the Commissioner's complying with the Tax Court rule requiring that he fully advise the taxpayer of his defense. In *Commissioner v. Estate of Long,* 304 F. 2d 136, at p. 143, the Court of Appeals for the Ninth Circuit directly held that the requirements of that rule, Tax Court Rule 14(b), must be met by the Commissioner.

True, the Court of Appeals here does not challenge that rule but on the contrary attempts to interpret the Commissioner's answer as showing that "he had no intention of limiting his basis for deficiencies to unreported income generated by Max alone." This distortion of the Commissioner's answer, wherein the Commissioner charged that the income alleged by him was derived from "*Max Steinberg's* business, investments, and/or other sources" (italics supplied), is so gross that it can only be evaluated as an attempt to cover the clear conflict with the *Long* case. The conflict is not only there but in a form so contemptuous of the English language, common sense, and elemental justice that it should not go unchallenged by this court.

2. As a second reason for granting the writ we submit that the distortion of language by the Court of Appeals shown above is of such a character that it calls for exercise of the supervisory function of this Court. Rule

19-1(b) of this Court. We suggest that it goes so far as even to strike at due process.

3. As a third reason for granting the writ we submit that the decision below presents a deviation from *United States v. Massei*, 355 U.S. 595. That case held that in a net-worth fraud case the Commissioner could carry his burden of proof without showing a likely source. But it did not hold that where, as here, in the case of a joint return, the Tax Court wholly absolved the husband, and the Commissioner failed to allege income of the wife but on the contrary conceded that there was "not even a hint of a source of taxable income" to her, that even then the Commissioner had carried his burden of proof.

Wherefore, petitioners pray that this Court issue the writ of certiorari sought herein to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

APPENDIX.

Opinion of the United States Court of Appeals.

United States Court of Appeals, for the Second Circuit.

No. 55—September Term, 1966.
(Argued September 27, 1966
Decided October 10, 1966.)

Docket No. 30491

Estate of Max Steinberg, Deceased, Pearl Steinberg, Executrix and Pearl Steinberg, Individually, Petitioners, against Commissioner of Internal Revenue, Respondent.

Before:

Moore, Friendly and Kaufman, Circuit Judges.

Appeal from the decision of the Tax Court, Austin Hoyt, *Judge,* that there were deficiencies in income taxes due from the petitioners for the taxable years 1950 and 1951.

Affirmed.

George T. Altman, Beverly Hills, California, for petitioners.

Mitchell Rogovin, Assistant Attorney General (Meyer Rothwacks, John P. Burke, Attorneys, Department of Justice, Washington, D. C., on the brief), for respondent.

Moore, *Circuit Judge:*

Max and Pearl Steinberg (Petitioners) were married in 1942. The Commissioner of Internal Revenue (Commissioner) determined deficiencies against Max for the years 1947, 1948, and 1949, when Max and Pearl filed separate returns, and against both for 1950 and 1951, when they filed a joint return. Petitioners

petitioned the Tax Court for a redetermination of the deficiencies. The assessment of a deficiency for each year concerned was barred by the statute of limitations unless the return for that year was fraudulent. The burden of showing fraud was on the Commissioner. A decision of no deficiency was entered for the years 1946, 1947, and 1948, but deficiencies were determined against petitioners for 1950 and 1951. Only the latter determination is appealed from.

Since Max died shortly after the trial in the Tax Court, Pearl alone prosecutes this appeal in her own right and as executrix of Max's estate.

Petitioners claim that the Commissioner has not met his burden of proving fraud. We disagree. By using the "increase in net worth" method, the Commissioner showed that petitioners received income which they did not report in 1950 and 1951. The net worth figures were the result of an extensive investigation by government agents into the financial affairs of both Pearl and Max, and included the assets and expenses of both of them. The investigation did not reveal the source of the income. Petitioners claimed that Pearl had a substantial cash hoard accumulated in years prior to 1946, the investment and expenditure of which during the years 1946-51 accounted for the increase in net worth. They claimed many non-taxable sources of the cash, but a careful investigation invariably revealed that the claims were untrue.

The Tax Court felt, and we agree, that fraud had been established by the petitioners' insistence upon giving the government agents false leads as to the source of the alleged cash hoard, and by the use of camouflaged and hidden bank accounts.

Testifying before the Tax Court as an adverse witness called by the Commissioner, Pearl asserted for the first time that the source of an undetermined portion of the cash hoard was a prominent gentleman whom she had hoped to marry but who had died in 1931. She testified that for several years he had periodically given her little bags of money which she had placed unopened and uncounted in a safe deposit box. She refused to reveal his identity because of a promise not to do so. Because of this refusal, this testimony was stricken. Petitioners claim this was error. Even if petitioners are correct, which we need not decide, they were not prejudiced by the action. The same court which ordered the testimony stricken said later, in its finding of facts:

> "Even if all of her testimony were still before us, we would reach the same conclusion. We observed her demeanor on the witness stand and have compared her tale of the unnamed suitor . . . with her previous statements as to the source of her cash accumulations. We could not give credit to her account even if she had candidly identified for the first time at trial her phantom friend, and certainly her failure to disclose the alleged amount of her cash hoard renders the testimony almost valueless for purposes of an attack on the net worth computation." 24 T. C. M. at 1254.

Petitioners' final complaint is that the Commissioner's answer in the Tax Court did not advise the petitioners fully of the nature of the defense as required by Rule 14(b) of the Tax Court. Specifically, petitioners claim they did not know that the Commissioner was relying on increases of combined net worth due to Pearl's in-

come. The Commissioner's answer before the Tax Court leaves no doubt that he did not know where the unreported income came from, and that he had no intention of limiting his basis for deficiencies to unreported income generated by Max alone. Thus, petitioners' claim that the answer was insufficient to support a determination of deficiencies based on income generated by Pearl is without merit.

Affirmed.

Excerpts From Commissioner's Answer in the Tax Court.

7. Further answering the petition, respondent alleges affirmatively as follows:

. . . . .

(c). During the taxable year 1950 the petitioners received income from petitioner Max Steinberg's business, investments, and/or other sources not disclosed in their income tax return in the amount of $38,733.75, which amount is represented by an unexplained increase in petitioners' net worth for said taxable year as set forth in the year designated in the computation of income annexed hereto and made a part hereof as Exhibit 1.

. . . . .

(e). During the taxable year 1951 the petitioners received income from petitioner Max Steinberg's business, investments, and/or other sources not disclosed in their income tax return in the amount of $33,626.77, which amount is represented by an unexplained increase in petitioner's net worth for said taxable year as set forth in the year designated in the computation of income annexed hereto and made a part hereof as Exhibit 1.

Quotation From "Brief for Respondent" in the Tax Court—Last Paragraph Page 52, First Paragraph Page 53, Thereof.

In summary, there is no evidence in the record of non-taxable income received by either Max or Pearl Steinberg, except $2,500 to Pearl Steinberg from Harry B. Davis' estate in 1929 and $1,500 received by Pearl Steinberg from her mother's estate in 1932. Further, there is not even a hint of a source of taxable income to Pearl Steinberg during the taxable years involved, other than the income reported by her. Finally, there is a strong possibility of a taxable source of income to Max Steinberg.

By reason of all the foregoing respondent submits that the increases in net worth represent taxable income to Max Steinberg for 1947, 1948 and 1949 and taxable income to Max and Pearl Steinberg for 1950 and 1951. Respondent further submits that the evidence is clear and convincing to prove his determination of fraud.

In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 949

ESTATE OF MAX STEINBERG, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED SATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The Commissioner determined income tax deficiencies against Max Steinberg (now deceased) individually for 1947, 1948 and 1949 (for which years he had filed separate rather than joint returns), and against both Steinberg and his wife Pearl jointly for 1950 and 1951 (for which years they had filed joint returns) (R. 19-20).[1] Such deficiencies were based

[1] "R." refers to the appendix to petitioners' brief in the court of appeals.

on the net worth method, and the Commissioner determined that the taxpayers had unreported net income totaling $130,440.89 for 1947 through 1949, and $72,360.52 for 1951 and 1952 (R. 24-25).[2] The Tax Court held (R. 29) that there was convincing evidence that during the years involved the taxpayers, "as a husband and wife team, were in possession of funds and received income of unidentified origin greatly in excess of gross income reported, and of any previously accumulated funds properly accounted for." The court ruled (R. 31-32), however, that the Commissioner had failed to establish his case against Max for the years 1947 through 1949. It stated (*ibid.*) that although the deficiencies were asserted solely against Max individually, the increases in net worth were attributed "almost entirely to funds or property standing in the name of or belonging to Pearl"; and that the evidence did not show "which increases, if any, were his alone during the years 1947 through 1949" and did not link Max "as a likely source of income, to Pearl's increase in net worth."

The Tax Court upheld the deficiencies against both Max and Pearl for 1950 and 1951 (when joint returns had been filed), since the evidence showed "substantial increases over and above [taxpayers'] reported income plus all other nontaxable income or

---

[2] The assessment of such deficiencies was barred by the statute of limitations unless the taxpayers had committed fraud. The Tax Court held that there was "cogent evidence of fraud" (R. 33), and the court of appeals upheld the finding of fraud (Pet. App. 2). That finding is not challenged here.

accretions to net worth from proven sources" (R. 29-30) and "[t]he increase in net worth for those years would, of course, include any income derived by or property belonging to either spouse" (R. 33).

In affirming the Tax Court, the court of appeals stated that "[b]y using the 'increase in net worth' method, the Commissioner showed that petitioners received income which they did not report in 1950 and 1951"; that the "net worth figures were the result of an extensive investigation by government agents into the financial affairs of both Pearl and Max"; and that although the investigation "did not reveal the source of the income," it did show that Pearl's claims that prior to 1946 she had accumulated a substantial cash hoard from "many non-taxable sources" were "untrue" (Pet. App. 2).

The court of appeals correctly upheld the deficiencies for 1950 and 1951, and there is no occasion for further review.

Petitioners contend (Pet. 2, 4) that in his answer in the Tax Court, the Commissioner stated that his case rested upon the claim that Max had additional income for 1950 and 1951 and disclaimed any reliance upon additional income of Pearl; and that the Tax Court's reliance upon evidence of Pearl's additional income for those years violated Rule 14 of its Rules of Practice, which requires the answer to "advise the petitioner and the Court fully of the nature of the defense" (Pet. 3). The portions of the answer upon which they rely (Pet. App. 4), however, stated that in those years "petitioners" (emphasis added) received unreported income from Max's "busi-

ness, investments, and/or other sources." The court of appeals reasonably interpreted these statements as putting the taxpayers on notice that the Commissioner was not restricting his case to proof of "unreported income generated by Max alone" (Pet. App. 4).

Petitioners have not shown that they suffered any prejudice from the alleged deficiencies in the answer; they point to no evidence they refrained from offering because of belief that the Commissioner was limiting his case to proof of Max's unreported income. Indeed, the Commissioner may even change his theory of tax liability on appeal, provided that the taxpayer suffers no disadvantage therefrom. *Commissioner* v. *Hopkinson*, 126 F. 2d 406, 409 (C.A. 2); cf. *Hormel* v. *Helvering*, 312 U.S. 552, 560 (further proceedings ordered to allow taxpayer opportunity to produce evidence relevant to new theory of liability adopted on appeal). Furthermore, the Tax Court did not find, as petitioners contend (Pet. 4-6), that Pearl was the source of the additional income; it found that Pearl and Max received the additional income "as a husband and wife team" (R. 29).

Petitioners further contend (Pet. App. 4) that the Commissioner in his brief before the Tax Court similarly disclaimed reliance on proof that Pearl had any unreported income. In the excerpt of the brief which they quote (Pet. App. 5), however, the Commissioner stated only that the evidence did not disclose any source of her additional unreported income. In a net worth case the government need not establish a likely source of the unreported income where its investiga-

tion negatives the non-taxable sources that the taxpayer has suggested. *United States* v. *Massei*, 355 U.S. 595; *Holland* v. *United States*, 348 U.S. 121, 137-138. The Tax Court properly took account of this rule in holding that the Commissioner had proven fraudulent understatement of income for 1950 and 1951 (R. 33-34).

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Solicitor General.

MITCHELL ROGOVIN,
Assistant Attorney General.

JOSEPH M. HOWARD,
JOHN P. BURKE,
Attorneys.

FEBRUARY, 1967.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1967 245796 597

IN THE

Supreme Court of the United States

October Term, 1966
No. 949

Estate of MAX STEINBERG, *et al.*,

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COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

MEMORANDUM OF PETITIONERS IN REPLY.

Respondent now, although in carefully chosen words, clearly confesses error of the court below—the error pointed out in our Petition, p. 6, which contains a clear conflict with the Ninth Circuit. Respondent attempts to counter the error by completely shifting his position, asserting, and for the first time, that petitioners have not been prejudiced, that they have not indicated any evidence they failed to offer because of belief that the Commissioner was limiting his case to proof of unreported income of Max alone.

But just as it is possible, under the doctrine of *United States v. Massei*, 355 U.S. 595, for the Commissioner to prove a negative, the non-existence of "all possible sources" of nontaxable income, so it is possible for the

taxpayer to prove a negative, the non-existence of "all possible sources" of taxable income. Had petitioners even suspected that the Commissioner was alleging taxable income of Pearl as well as Max, or of Pearl and Max "as a husband and wife team," they would have proceeded to prove the non-existence of all possible sources of such income.

In view of respondent's shift of position, the least to which we should be entitled now is the opportunity to make that proof. *Hormel v. Helvering,* 312 U.S. 552, 560, cited here by respondent on that very point. We should not be required to make it, since the Commissioner has, we submit, already admitted, in effect, that no sources of such taxable income exist. But we are prepared to make that proof, if required.

We submit now also that the issue is one of the greatest importance in the administration of the revenue. We refer, of course, to the second of the questions presented in our petition. The tax law services show that net-worth fraud cases are among the most common in the entire field of tax litigation. *Massei* made it possible in such a case for the Commissioner to carry his burden of proof by showing, in addition to his net-worth computation, the non-existence of "all possible sources" of nontaxable income. Correspondingly the taxpayer should be allowed to defend by showing the non-existence of all possible sources of taxable income. The effect, of course, adding together the two negative showings, and assuming the term "income" to cover any kind of addition to net worth, would be that the Commissioner may have erred in his net-worth computation, such as by failing to prove the non-existence of any additional opening assets.

In any case, we submit that the Commissioner's confession of error of the court below, in respect to the meaning of his answer in the Tax Court—an error which contains a clear conflict with the Ninth Circuit—dictates that the petition should be granted and a hearing held by this Court.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

IN THE

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No. 949

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

MOTION FOR REMAND.

Petitioners hereby move the Court for remand to the Tax Court of the United States for further proceedings to allow petitioners an opportunity to produce evidence they did not offer because of belief that the Commissioner was limiting his case to proof of the unreported income of Max Steinberg alone.

Respondent in his Memorandum in Opposition conceded in effect that at least there was ground for such belief by petitioners. Respondent there also, at page 4, cited *Hormel v. Helvering*, 312 U.S. 552, 560, as allowing in that situation the further proceedings hereby requested.

Wherefore, petitioners pray that this motion be granted.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.